Pension Consulting Alliance, Inc.

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Ms. Christianna Wood, CFA, CAIA
Senior Investment Officer, Global Equity
California Public Employees' Retirement System
400 Q Street,
Sacramento, California 95814

Dear Ms. Wood,

Following up upon your request I have spent a number of hours reading the attachments (with more emphasis upon the Agenda Item) and thinking about the challenge(s) you presented. In the preparation of this letter PCA did not undertake independent statistical and risk analysis, our review was limited to the documents presented. My thoughts about those challenges and how to put them into context follows:

First and foremost, I believe that any return premium objective must be attainable (not so high as to require significant and unwanted risk) and NOT generate the types of incentives that create poor risk management decisions. The alignment of interests between the portfolio manager(s) and the System's overall objectives must be clear and readily measurable. Second, I believe that any performance related compensation must be paid out over an extended period to maximize the potential for the retention of exceptional staff.

Now, to your questions:

1) I believe that, over time, it is very, very difficult for traditional active managers (in a multi-manager structure) to beat a broad benchmark. Transaction costs including market impact and fees combined with the reality of managers in many instances reverting to an average (and most, if not all sponsors retain managers when they are in the top deciles where there is only one direction to go) combine to make a large multi-manager structure look like a very expensive index fund. There are exceptions, those are in my opinion the sponsors that make significant bets on managers that have earned their confidence and do not OVER diversify. There are better ways to gain market exposure than a traditional multi-manager active strategy.

2) I believe that any and all efforts to contain and control costs (at all levels) are efforts well spent.

3) CalPERS' global equity program has had areas of great success. Corporate Governance and the Hedge Fund strategies come to mind. The programs that are successful should be expanded (to the extent that is feasible) and new programs that capture the creativity and skills of the staff and reflect the Investment Committee's desire for innovation and leadership are the ones that should be followed-up.

4) The lines between public and private equity and debt markets are, in my opinion, becoming less and less clear. The Global Equity Group should be doing more with both the AIM and Real Estate groups as well as fixed income. To the extent that other investors cannot cross an asset class line that creates an artificial inefficiency that has the potential to be exploited.

5) In light of the portfolio's size and degree to which it is indexed I believe that a reasonable premium is between 25 and 50 basis points. A return premium any higher than that would require a level of active risk that raises the potential for results that no board or consultant, let alone staff, should be willing to accept,

I hope these thoughts foster the dialogue you intended and I look forward to being part of the ongoing discussion and debate.

Allan Emkin
Managing Director

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